

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-1 : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI K. NARASIMHA CHARY, JUDICIAL MEMBER

ITA No.1420/Del/2014
Assessment Year : 2006-07

Avaya India Private Limited,
Unit No.202, 2nd Floor,
Building Platina, Plot No.C-59,
G-Block, Near Citibank, Bandra
Kurla Complex, Bandra (East),
Mumbai.
PAN: AAECA3592N

Vs. DCIT,
Circle-2(1),
New Delhi.

(Appellant)

(Respondent)

Assessee By : Shri Anubhav Rastogi, Advocate
Department By : Shri Kumar Pranav, CIT, DR

Date of Hearing : 30.11.2017
Date of Pronouncement : 30.11.2017

ORDER

PER R.S. SYAL, VP:

This appeal filed by the assessee arises out of the final assessment order passed by the Assessing Officer (AO) on 31.12.2013 u/s 254 read

with section 143(3) and 144C of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2006-07.

2. Succinctly, the facts of the case are that an assessment order was passed by the Assessing Officer on 16.09.2010 u/s 143(3) read with section 144C of the Act making an addition of Rs.4,56,86,300/- on account of variation in the income as a consequence of the order passed by the Transfer Pricing Officer (TPO). The said order was challenged before the Tribunal. Vide order dated 25.02.2011, the Tribunal, in ITA No.5150/Del/2010, decided most of the issues. One of the filters applied by the TPO, as assailed in the appeal, was 'Wages to sale ratio between 30 to 60%.' This filter was adopted by the TPO in the light of the fact that the assessee was engaged in the business of software development which requires highly skilled manpower. Since wages constitute a major part of the total expenditure, the TPO held that filter of Wages/sales ratio between 30% to 60% should be applied, as the assessee had such Wages/sales ratio of 46.96%. The DRP approved the action of the TPO in this regard. It was contended before the Tribunal that the adoption of

filter of Wages to sales ratio between 30 to 60% was wrong and further even the same was not correctly applied in determining the comparability in certain cases. The Tribunal upheld the adoption of such a filter by means of discussion in para 19 onwards of its order. However, the objection of the assessee about wrong calculations made by the authorities below while applying this filter with respect to four parties described in para 11 of the order, was accepted and the matter was restored to the DRP for a fresh determination. The four parties as referred to in para 11 of the Tribunal order are: i) Melstar Information Technologies Limited; ii) SQL Star International Ltd.; iii) Sasken Communication Technologies Ltd.; and iv) Satyam Computer Services Ltd. Apart from that, the assessee also contended before the Tribunal that M/s Space Computer and Systems Ltd. was wrongly excluded simply on the ground that it was the first year of its operation, whereas, actually it was the 16th year. The Tribunal remitted this issue also to the DRP for carrying out verification and ascertaining if such contention of the assessee was correct and, further: 'whether the said party can be included in the list of comparables as per filtered criteria.' The matter

came up before the DRP for carrying out the exercise as directed by the Tribunal. Vide its order dated 20.09.2013, the DRP found from the Annual reports of Melstar Information Technologies Ltd. and Satyam Computer Services Ltd. that their 'Wages to sale ratio' was 57.88% and 58.28% respectively. Since the same was within the range of 30% to 60%, these companies were directed to be included in the list of comparables. However, such ratio in the case of SQL Star International Ltd. was determined by the DRP at 27.61% and in Sasken Communication Technologies Ltd. at 61.85%. That is how, these two companies were found to be lacking in so far as the application of filter of Wages to sale ratio (30% to 60%) was concerned. As regards the last company, namely, Space Computer and Systems Ltd., the assessee's contention was found correct that it was not the first year of this company. The DRP noticed that the direction of the Tribunal extended also to the application of correct filters. The DRP computed Wages to sale ratio of this company at 22.99%, which was held to be failing the filter. This resulted into the exclusion of this company as well. The assessee is aggrieved against the three exclusions directed by the DRP

which culminated into the final assessment order passed by the Assessing Officer that is impugned before us.

3. We have heard the rival submissions and perused the relevant material on record. It is an admitted position that the tribunal order remitting the matter to the DRP for the fresh exercise has attained finality inasmuch as both the sides have accepted the same. We now come to the *lis* that is involved in this appeal, namely, the exclusion of three companies by the DRP, which we will espouse in seriatim for determination.

(i) Sasken Communication Technologies Ltd.

4. The DRP has adopted the figure of Sales of this company at Rs.26,754.43 lac and Employee cost at Rs.16,548.36 lac. That is how, the ratio of Wage to sale was determined at 61.85%. The Id. AR contended that in the calculation of Employee cost, the DRP included not only Salaries and bonus; Contribution to Provident Fund and other funds; and Staff welfare (hereinafter collectively called 'the Employee cost') in respect of Direct costs incurred in providing software

development services, but also included the Employee cost in respect of Research and development expenses, Selling and marketing expenses and Administrative and general expenses. The Id. AR contended that such Employee cost in relation to R&D; Selling and marketing; and Administrative and general expenses ought to have been excluded from total the Employee cost in calculating the ratio of Wages to sales. It was contended that if such an exclusion of the Employee cost is made, then, this company passes the filter of Wages to sales ratio between 30% to 60%.

5. We are not convinced with the proposition put forth on behalf of the assessee. It is discernible from the 'Sales' figure taken by the DRP at Rs.26,754.43 lac that the same represents total Revenues of the company shown in its Profit & Loss Account. Not only the Employee cost of direct software development were borne by the assessee for rendering software development services but also the Employee cost in respect of R&D; Selling and marketing expenses; and Administrative and general expenses for earning the figure of total revenue. Obviously,

compensation for the Employee cost in respect of R&D; Selling and marketing expenses; and Administrative and general expenses is also embedded in the amount billed to the customers, which represents the figure of total `Sales` adopted by the DRP. If we exclude the Employee cost in respect of R&D; Selling & marketing; and Administrative & general expenses from the overall figure of Employee cost adopted by the DRP and continue with the figure of `Sales` at Rs.26,754.43 lac, it will give skewed result. It is axiomatic that once compensation for the Employee cost in respect of R&D; Selling & marketing; and Administrative & general expenses is also included in the amount of total `Sales` adopted for the ratio, the corresponding costs also need to be included in the Employee cost base. We, therefore, jettison the contention raised on behalf of the assessee. It is not disputed that if the Employee cost in respect of R&D; Selling & marketing; and Administrative & general expenses is included, then, the calculation done by the DRP is unimpeachable. We, therefore, uphold the impugned order in excluding Sasken Communication Technologies Ltd. from the list of comparables.

(ii) SQL Star International Ltd.

6. The DRP adopted the figure of `Sales' of this company at Rs.31.70 crore which includes not only the revenues from `Software and services' but also `Training course' and `Others'. A copy of Profit & Loss Account of this company is available at page 329 of the paper book, which gives the break-up of the figure of total Sales of Rs.31.70 crore, as `Software and services' (Rs.14.76 crore); `Training course' (Rs.15.43 crore); and `Others' (Rs.1.50 crore). As against that, the figure of `Employee cost', described as `Personnel expenses' in the Profit & Loss of this company, stands at Rs.8.75 crore, which has been adopted by the DRP for calculating the ratio. The Id. AR contended that revenue from `Training course' and `Others' should be excluded for working out the ratio of `Wages to sale'.

7. We are not convinced with the submission advanced before us for the *raison d'etre* that the Personnel expenses of Rs.8.75 crore are also in respect of the sources of revenue from `Training course' and `Others' in addition to `Software and services'. Once Personnel cost has been taken

on entity level, as the sequitur, the amount of `Sales` should also be taken at entity level without exclusion of revenue from `Training course` and `Others`. It is so for the reason that some sort of the employee cost is also incurred for earning such sources of income. On a specific query, the Id. AR put forth that there was no separate bifurcation of Personnel expenses in relation to income from software in the annual accounts of this company. In this view of the matter, it becomes clear that the calculation will have to be made at entity level as has been done by the DRP. Since the assessee fails this filter, we hold that this company has been rightly expunged from the list of comparables.

(iii) Space Computer and Systems Ltd.

8. We have noticed above that the direction of the Tribunal was to verify if this company was in the first year of operation and, further, if it satisfies the other filters adopted by the TPO. The DRP verified the first aspect and found the assessee's contention correct inasmuch as it was not the first year of the company. As regards the other direction, the DRP observed that the : `Wages/sales ratio is only 22.99%, which fails

filter applied by TPO'. That is how, this company got excluded from the final tally of comparables. The assessee is aggrieved against this exclusion.

9. Having heard both the sides and perused the relevant material on record, the Tribunal finds it as a factual position that this company was found to be wanting only in respect of 'Wages to sale ratio.' The DRP computed such ratio at 22.99% by taking the amount of 'Sales' at Rs.1.70 crore and 'Employee cost' at Rs.39.27 lac. We have gone through the Annual report of this company, a copy of which is available in the paper book. It is discernible that the amount of 'Sale' has been correctly taken by the DRP. As regards the 'Employee cost', it is noticed that unlike Sasken Communication Technologies Ltd., the DRP included only the figure of Salaries and wages in general section without including Recruitment charges and Staff welfare expenses as given under the head 'Administrative expenses' and Consultant fees and Staff welfare expenses as given under the head 'Operating expenses.' Since no difference in the nature of 'Staff welfare expenses' incurred by

Sasken Communication Technologies Ltd. and this comparable has been pointed out by the DRP, we hold that the above referred expenses should have also been included in the 'Employee cost' base as has been done in the case of Sasken Communications. 'Recruitment charges' and 'Consultant fees' are also part of employee cost which ought to have been included by the DRP in the overall figure of 'Employee cost' of this company that has been taken at Rs.39.27 lac. If these four items are included, total 'Employee cost' comes to Rs.75,80,157/-, which gives ratio of Wages to sale at 44.38%, thus, satisfying the filter of 30% to 60%. We, therefore, overturn the impugned order on this score and order to include this company in the list of comparables.

10. To sum up, we set aside the impugned order on the issue of addition towards transfer pricing adjustment and remit the matter to the file of AO/TPO for a fresh determination of the arm's length price in the hue of our above discussion. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings.

11. In the result, the appeal is partly allowed for statistical purposes.

The order pronounced in the open court on 30.11.2017.

Sd/-

[K. NARASIMHA CHARY]
JUDICIAL MEMBER

Dated, 30th November, 2017.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

Sd/-

[R.S. SYAL]
VICE PRESIDENT

AR, ITAT, NEW DELHI.